

No. 7662

In the United States Circuit Court of
Appeals for the Ninth Circuit

G. M. STANDIFER CONSTRUCTION CORPORATION,
PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

ON PETITION FOR REVIEW OF DECISION OF THE UNITED
STATES BOARD OF TAX APPEALS

BRIEF FOR THE RESPONDENT

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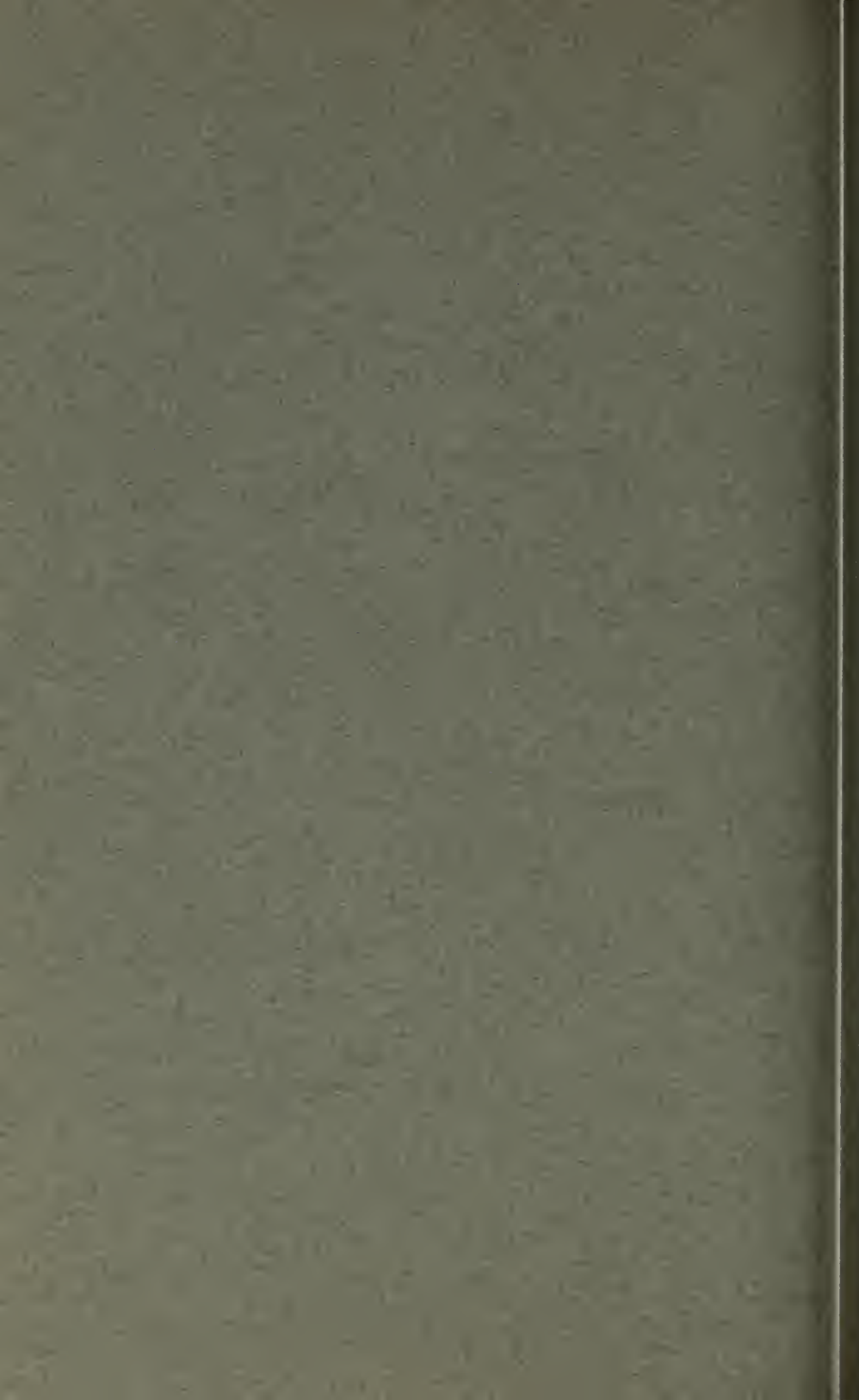
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INDEX

	Page
Opinion below.....	1
Jurisdiction.....	1
Question presented.....	2
Statutes and regulations involved.....	2
Statement.....	2
Summary of argument.....	5
Argument.....	6
Conclusion.....	12
Appendix.....	13-18

CITATIONS

Cases:

<i>American National Co. v. United States</i> , 274 U. S. 99.....	6
<i>Arthur & Co. v. Burke</i> , 83 Wash. 690.....	10
<i>Brown v. Commissioner</i> , 63 F. (2d) 66.....	12
<i>Burnet v. Sanford & Brooks Co.</i> , 282 U. S. 359.....	11
<i>M. A. Burns Mfg. Co. v. Commissioner</i> , 59 F. (2d) 504.....	6
<i>Byrne v. Crowinshield</i> , 17 Mass. 55.....	10
<i>Campbell v. Holt</i> , 115 U. S. 620.....	10
<i>Carr v. Commissioner</i> , 28 F. (2d) 551.....	11
<i>Charleston & W. C. Ry. Co. v. Burnet</i> , 50 F. (2d) 342, affirm- ing 17 B. T. A. 569.....	7
<i>Chicago, R. I. & P. Ry. Co. v. Commissioner</i> , 47 F. (2d) 990, affirming 13 B. T. A. 988, certiorari denied, 284 U. S. 616..	7
<i>Louis S. Cohn Co. v. Commissioner</i> , 12 B. T. A. 1281.....	7
<i>Commissioner v. Liberty Bank & Trust Co.</i> , 59 F. (2d) 320..	11
<i>Doyle v. Mitchell Brothers Co.</i> 247 U. S. 179, affirming 235 Fed. 686.....	11
<i>Lichtenberger-Ferguson Co. v. Welch</i> , 54 F. (2d) 570.....	6
<i>McCabe Lathe & Machine Co. v. Commissioner</i> , 9 B. T. A. 1137.....	7
<i>McConnell v. Commissioner</i> , 16 B. T. A. 714.....	7
<i>McElmoyle v. Cohen</i> , 13 Pet. 312.....	10
<i>Peabody Coal Co. v. Commissioner</i> , 18 B. T. A. 1081, af- firmed, 55 F. (2d) 7, certiorari denied, 287 U. S. 605....	11
<i>Putnam Nat. Bank v. Commissioner</i> , 50 F. (2d) 158.....	11
<i>United States v. Anderson</i> , 269 U. S. 422.....	6
<i>Walch v. Mayer</i> , 111 U. S. 31.....	10
<i>Wichita State Bank & T. Co. v. Commissioner</i> , 69 F. (2d) 595, certiorari denied, 293 U. S. 562.....	11.

Statutes:

	Page
Revenue Act of 1926, c. 27, 44 Stat. 9:	
Sec. 212 (U. S. C. App., Title 26, Sec. 953)-----	13
Sec. 213 (U. S. C. App., Title 26, Sec. 954)-----	13
Sec. 230 (U. S. C. App., Title 26, Sec. 981)-----	14
Sec. 232 (U. S. C. App., Title 26, Sec. 984)-----	14
Sec. 233 (U. S. C., App., Title 26, Sec. 985)-----	14
Revenue Act of 1928, c. 852, 45 Stat. 791: Sec. 117-----	14
Oregon Code, 1930 Edition, Vol. 1:	
1-201-----	15
1-204-----	15
Remington's Revised Statutes of Washington, 1932 Edition, Vol. 2:	
Sec. 155-----	15
Sec. 157-----	15
Miscellaneous:	
37 Corpus Juris 729-731-----	10
Treasury Regulations 69:	
Art. 22-----	16
Art. 23-----	17
Art. 31-----	17
Art. 50-----	17
Art. 541-----	18
Treasury Regulations 74:	
Art. 654-----	18

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OPINION BELOW

The only previous opinion in this case is that of the United States Board of Tax Appeals (R. 22-30) reported in 30 B. T. A. 184.

JURISDICTION

The petition for review involves a deficiency in Federal income tax in the amount of \$4,999.57 determined against the petitioner for the calendar year 1928. The decision of the Board of Tax Appeals was entered June 7, 1934 (R. 31), and the

case is brought to this Court by a petition for review filed September 5, 1934 (R. 32-38), pursuant to Sections 1001-1003 of the Revenue Act of 1926, c. 27, 44 Stat. 9, 109, 110, as amended by Section 1101 of the Revenue Act of 1932, c. 209, 47 Stat. 169.

QUESTION PRESENTED

The only question presented is whether the Board of Tax Appeals erred in holding that wages of employees, accrued and deducted from income in prior years but never paid by the petitioner, were properly included in income for 1927 when dissolution of the petitioner was authorized and the amounts accrued for such payment became available for distribution to stockholders, thus reducing net loss for that year deductible from 1928 income.

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved are printed in the Appendix, *infra*, pp. 13-18.

STATEMENT

The respondent determined a deficiency of \$8,605.20 in the petitioner's tax liability for 1920 (R. 8) and petitioner appealed to the Board of Tax Appeals (R. 3). The cause was submitted to the Board upon an agreed statement of facts (R. 14-22). In an opinion filed March 27, 1934 (R. 22-30), the Board disallowed a part of the deficiency determined by the respondent and en-

tered judgment against the petitioner (R. 31) for the sum of \$4,999.57. This appeal is taken from that part of the Board's decision adverse to the petitioner.

Insofar as material here the facts (R. 14-22, 23-30) may be briefly stated. The petitioner, an Oregon corporation with offices in Portland, was incorporated in 1917, and during the years 1917 to 1921 was engaged in the business of building steel and wooden ships at Portland, Oregon, and Vancouver, Washington. Large numbers of laborers were employed in this work. In February 1920, as the result of a strike by the employees at its Vancouver yards, the petitioner agreed to an increase in wages which was made retroactive to 1919.

Petitioner's accounts were kept and its income tax returns for all years were made on an accrual basis. When the increased wages were agreed to in 1920 they were accrued upon the petitioner's books of account. Of the total amount accrued for increased wages the sum of \$26,951.09 was never paid by the petitioner. While some of the wages accrued in 1920 but never paid were retroactive to 1919, the total amount was used to reduce petitioner's gross income for 1920, either as cost of construction or as expenses, with the possible exceptions of two small items which accrued in 1921 and may have been taken as deductions in that year. No checks were ever made out for the increased wages here involved. There was no con-

troverly as to the amount of increased wages. They were not paid because the employees never called for them.

The petitioner discontinued its shipbuilding operations in 1921, but was continued as an active corporation until 1927. During this period it carried on its books as an accrued liability the sum of \$26,591.09, representing its liability for the increased wages which had not been paid. This amount was never restored to surplus on the books of the petitioner, and was never reported as income in its tax returns.

Pursuant to resolutions adopted July 2, 1927, by petitioner's stockholders and directors, a certificate of dissolution was filed with the Corporation Commissioner of the State of Oregon on August 30, 1927, and on that date the Corporation Commissioner issued his certificate dissolving the petitioner.

Petitioner filed an income-tax return for 1927 which disclosed a net loss of \$68,709.92. In its return for 1928 the petitioner reported net income of \$6,171.29 after deducting the net loss of \$68,709.92 reported for 1927. In auditing these returns the respondent added certain items to income for 1927, including the \$26,951.09 here in controversy, thereby eliminating the net loss of \$68,709.92 for that year. This loss was then disallowed as a deduction from 1928 income and a deficiency determined for that year (R. 8-11). The Board of Tax Appeals held that the other adjustments to 1927 income

made by the respondent were erroneous, but sustained his action in taxing as income for that year the unpaid wages amounting to \$26,951.09.

SUMMARY OF ARGUMENT

By agreement with its employees the petitioner became liable in 1920 for a substantial amount of increased wages for the years 1919 and 1920. The full amount of this liability represented a proper item for accrual upon the books of the petitioner for 1920, and was properly claimed and allowed as a deduction from petitioner's income in computing its Federal income tax liability for that year. Of the amount thus accrued in 1920 and deducted from income sums aggregating \$26,951.09 were never called for by the employees and never paid by the petitioner. This unpaid balance was properly carried as an existing liability upon petitioner's books during subsequent years.

When petitioner, upon its own application, was dissolved in 1927 the reserve for unpaid wages became available for distribution to stockholders in liquidation of the petitioner. The record discloses no intention on the part of the petitioner or its trustees in dissolution to retain this fund for the purpose for which it was originally set aside, and the facts clearly would not justify longer withholding these funds from distribution. Under the circumstances the amount of this reserve represented taxable income in 1927 when it became available for the general purposes of the petitioner. The

possibility that any action by unpaid employees to recover the amount due them may have become barred prior to 1927 is not controlling in view of the fact that the liability had not been extinguished and the petitioner continued to carry the account upon its books as an existing liability. However, after dissolution of the petitioner it was the duty of its trustees in dissolution, in protecting the interest of creditors and stockholders, to impose any valid defense to actions to collect these unpaid wages.

ARGUMENT

I

By agreement with its employees in 1920 the petitioner became liable for a substantial amount of increased wages. The full amount of this liability was accrued upon the books of the petitioner and used to reduce its 1920 income either as cost of construction or as expenses. Out of the total amount thus accrued and deducted the sum of \$26,951.09 was never paid to the petitioner's employees and was carried as an accrued expense in petitioner's books until dissolution in 1927. Under the petitioner's method of keeping its accounts the accrual of increased wages in 1920 was proper and the amount accrued represented proper deduction from income. *United States v. Anderson*, 269 U. S. 422; *American National Co. v. United States*, 274 U. S. 99; *Lichtenberger-Ferguson Co. v. Welch*, 54 F. (2d) 570 (C. C. A. 9th); *M. A. Burns Mfg. Co. v. Commissioner*, 59 F. (2d) 504 (C. C. A. 9th);

McCabe Lathe & Machine Co. v. Commissioner, 9 B. T. A. 1137; *Louis S. Cohn Co. v. Commissioner*, 12 B. T. A. 1281; *McConnell v. Commissioner*, 16 B. T. A. 714. Whether the amounts thus accrued and deducted but never actually paid represent taxable income in 1927 under the facts of this case is the only question for determination here.

The Revenue Act of 1926 (Section 230) imposes a tax upon the net income of every corporation. Net income (Section 232) means the gross income, as defined by Section 233 (a) and 213 (a), less the deductions allowed by law. Gross income, as defined in Section 213 (a), includes "gains or profits and income derived from any source whatever." Net income for tax purposes is to be computed in accordance with the method of accounting regularly employed in keeping the books of the taxpayer (Section 212 (b)).

Whether the amount here in controversy is taxable income in 1927 is controlled by the decision in *Chicago, R. I. & P. Ry. Co. v. Commissioner*, 47 F. (2d) 990 (C. C. A. 7th), affirming 13 B. T. A. 988, certiorari denied, 284 U. S. 616; and *Charleston & W. C. Ry. Co. v. Burnet*, 50 F. (2d) 342 (App. D. C.), affirming 17 B. T. A. 569.

In *Chicago, R. I. & P. Ry. Co. v. Commissioner*, *supra*, the taxpayer, in the regular course of its business, issued checks for wages and in payment of loss and damage claims. Many of the pay checks were never called for by employees entitled to them, and some of the loss and damage checks were

never cashed by the payees. The amounts of these checks were charged to operating expenses on the books of the taxpayer and taken as deductions in its income-tax returns for the years so charged. Checks which were not presented for payment at the end of two years were credited to profit and loss on the taxpayer's books. Such checks as were thereafter presented for payment were paid and the amount thereof charged to profit and loss. The Board of Tax Appeals and the Circuit Court of Appeals held that the amounts credited to profit and loss represented taxable income in the years they were so credited.

In *Charleston & W. C. Ry. Co. v. Burnet, supra*, the taxpayer, whose books were kept on an accrual basis, followed the practice of preparing its pay rolls for wages due its employees from time books or other records. The totals of such pay rolls were charged to operating expense and credited to a pay rolls liability account. The pay rolls liability account was then debited at the end of each month with amounts actually paid. It was the practice of the taxpayer to consider all items of unclaimed wages as a definite liability and to pay the employees to whom such wages were due when they were called for, irrespective of any statutory period of limitation. In 1924 it credited to profit and loss the sum of \$441.05, representing the aggregate of various unpaid wage items due employees for the year 1921, which had been accrued and claimed as deductions from income for that year.

The amount so credited to profit and loss was held to be taxable as income in the year of the credit.

II

Petitioner argues (Br. 9-10) that if the amount involved constituted taxable income at any time it should be taxed in the year or years that action to recover the unpaid wages became barred. The decisions in *Chicago, R. I. & P. Ry. Co. v. Commissioner*, and *Charleston & W. C. Ry. Co. v. Burnet*, *supra*, are sought to be distinguished on the ground that action to collect the unpaid wages in those cases was not barred at the time they were included in income. In neither case is there a specific finding to this effect, and in the *Charleston* case it is definitely stated that the taxpayer considered the unpaid wages as a definite liability and always paid them when called for "without consideration of any statutory period of limitation."

This argument of petitioner must be unavailing for several reasons. In the first place, it is based upon the assumption that collection of these unpaid wages was barred after three years, but the facts do not support this assumption. Under the laws of Washington (Remington's Revised Statutes (1932 Edition) Sections 155-159) there is a six-year limitation upon actions based upon a written contract or a liability, expressed or implied, based upon a written agreement, and under the laws of Oregon (Code of 1930, Sections 1-201 to 1-204) there is a six-year limitation upon actions based

upon a contract or liability, express or implied. It is not shown that the agreement under which petitioner became liable for the increased wages is governed by a shorter period. Furthermore, an action for wages is a transitory action and can be brought wherever jurisdiction of the person of the defendant or service can be obtained. The plea of the statute of limitation is a plea to the remedy and not to the right. Hence the law of the forum prevails. *Walch v. Mayer*, 111 U. S. 31; *McElmoyle v. Cohen*, 13 Pet. 312; *Byrne v. Crowninshield*, 17 Mass. 55; *Arthur & Co. v. Burke*, 83 Wash. 690; 37 Corpus Juris 729-731. There is no property right in a statute of limitations which affects only the remedy and does not extinguish the liability. *Campbell v. Holt*, 115 U. S. 620. Since the employees' right to the unpaid wages in question had not been extinguished, and the petitioner continued to carry the account upon its books as a definite liability, there is no basis for saying the amount should have been taxed in a prior year. For all that appears, the petitioner still intended to pay these unpaid wages, if called for, up to the time of its dissolution.

III

Nor can petitioner take refuge in the fact that the reserve for unpaid wages was never credited to profit and loss upon its books. Such an argument, if adopted, would provide a most flagrant method of defeating the right of the Government to collect taxes otherwise due. Facts control, not

book entries (*Doyle v. Mitchell Brothers Co.*, 247 U. S. 179, affirming 235 Fed. 686 (C. C. A. 6th)), and if there is any factual justification for the respondent's action the decision of the Board should be affirmed. The theory underlying the restoration to income of reserves for unpaid liabilities is that the reason for the reserve has ceased to exist, and since the taxpayer has already had the benefit of the deduction just as if the liabilities had actually been paid, the amount of the reserve should be taxed when it is again made available for the general purposes of the taxpayer. Cf. *Peabody Coal Co. v. Commissioner*, 18 B. T. A. 1081, affirmed on another issue, 55 F. (2d) 7 (C. C. A. 7th), certiorari denied, 287 U. S. 605.

The cases do not differ in principle from those cases in which items previously allowed as deductions from income are treated as income for the years in which they are recovered by the taxpayer. *Burnet v. Sanford & Brooks Co.*, 282 U. S. 359; *Putnam Nat. Bank v. Commissioner*, 50 F. (2d) 158 (C. C. A. 5th); *Wichita State Bank & T. Co. v. Commissioner*, 69 F. (2d) 595 (C. C. A. 5th), certiorari denied. 293 U. S. 562; *Carr v. Commissioner*, 28 F. (2d) 551 (C. C. A. 5th); *Commissioner v. Liberty Bank & Trust Co.*, 59 F. (2d) 320 (C. C. A. 6th).

Since the petitioner treated the amount on its books as an existing liability which it had every right to discharge at any time unclaimed wages might be called for, there was no ground on which

the respondent could restore the amount of the liability to income in prior years. However, when the petitioner decided to dissolve, and a certificate of dissolution was issued by the proper state official, the amount of the reserve then, if ever, became available for the general purposes of the corporation. It is not shown that the petitioner intended to retain this fund any longer for the purpose of paying unclaimed wages, and it would be unreasonable under the circumstances to assume it had any such intention. It is immaterial that under State law the corporate entity was continued for the protection of creditors and stockholders during the period of dissolution. As this Court very aptly said in *Brown v. Commissioner*, 63 F. (2d) 66, at page 68:

Should the practice urged by petitioner be followed, the collection of the revenues of the national government would be uncertain, for the government would be taking the chance that the money is still available for taxation during subsequent years, and that the taxpayer is still solvent.

CONCLUSION

The decision of the Board of Tax Appeals is correct and should be affirmed.

Respectfully submitted.

FRANK J. WIDEMAN,
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SEWALL KEY,
F. E. YOUNGMAN,

Special Assistants to the Attorney General.

APRIL 1935.

APPENDIX

Revenue Act of 1926, c. 27, 44 Stat. 9, 109, 110:

SEC. 212. (a) In the case of an individual the term "net income" means the gross income as defined in section 213, less the deductions allowed by sections 214 and 206.

(b) The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section 200 or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year.

* * * * *

(U. S. C. App., Title 26, Sec. 953.)

SEC. 213. For the purposes of this title, except as otherwise provided in section 233—

(a) The term "gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * * of whatever kind and in whatever form paid, or from profes-

sions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * * (U. S. C. App., Title 26, Sec. 954.)

SEC. 232. In the case of a corporation subject to the tax imposed by section 230 the term "net income" means the gross income as defined in section 233 less the deductions allowed by sections 234 and 206, and the net income shall be computed on the same basis as is provided in subdivisions (b) and (d) of section 212 or in section 226. In the case of a foreign corporation or of a corporation entitled to the benefits of section 262 the computation shall also be made in the manner provided in section 217, (U. S. C. App., Title 26, Sec. 984).

SEC. 233. (a) In the case of a corporation subject to the tax imposed by section 230 the term "gross income" means the gross income as defined in sections 213 and 217, except that mutual marine insurance companies shall include in gross income the gross premiums collected and received by them, less amounts paid for reinsurance.

* * * * *

(U. S. C. App., Title 26, Sec. 985.)

Revenue Act of 1928, c. 852, 45 Stat. 791:

SEC. 117. NET LOSSES.

* * * * *

(c) *Net loss for 1926 or 1927.*—If for the taxable year 1926 or 1927 a taxpayer sustained a net loss within the provisions of the

Revenue Act of 1926, the amount of such net loss shall be allowed as a deduction in computing net income for the two succeeding taxable years to the same extent and in the same manner as a net loss sustained for one taxable year is, under this Act, allowed as a deduction for the two succeeding taxable years.

Oregon Code, 1930 Edition, Vol. I:

1-201. Accrual of actions—Commencement—Time limits—Objection, how taken.—Actions at law shall only be commenced within the periods prescribed in this title, after the cause of action shall have accrued, except where, in special cases, a different limitation is prescribed by statute. But the objection that the action was not commenced within the time limited shall only be taken by answer, except as otherwise provided in section 1-605 (L. 1862; D. Sec. 3; H. Sec. 3; B. & C. Sec. 3; L. O. L. Sec. 3; O. L. Sec. 3).

1-204. Six-year limitations.—Within six years—

1. An action upon a contract or liability, express or implied, excepting those mentioned in section 1-203; * * *.

Remington's Revised Statutes of Washington, 1932 Edition, Vol. 2:

Sec. 155. Limitations prescribed—Objections, how taken. Actions can only be commenced within the periods herein prescribed after the cause of action shall have accrued, except when in special cases a different limitation is prescribed by statute; but the objection that the action was not commenced within the time limited can only be taken by answer or demurred. (Cf. L. '54, p. 362,

Sec. 1; L. '60, p. 289, Sec. 1; L. '63, p. 85, Sec. 16; L. '69, p. 8, Sec. 25; L. '73, p. 8, Sec. 25; Cd. '81, Sec. 25; L. '85, p. 74, Sec. 1; L. '91, p. 90, Sec. 1; 2 H. C., Sec., 111.)

Sec. 157. Within six years.

Within six years:

* * * * *

2. An action upon a contract in writing, or liability express or implied arising out of a written agreement.

* * * * *

Treasury Regulations 69, promulgated under the Revenue Act of 1926:

ART. 22. *Computation of net income.*—Net income must be computed with respect to a fixed period. Usually that period is 12 months and is known as the taxable year. Items of income and of expenditures which as gross income and deductions are elements in the computation of net income need not be in the form of cash. It is sufficient that such items, if otherwise properly included in the computation, can be valued in terms of money. The time as of which any item of gross income or any deduction is to be accounted for must be determined in the light of the fundamental rule that the computation shall be made in such a manner as clearly reflects the taxpayer's income. If the method of accounting regularly employed by him in keeping his books clearly reflects his income, it is to be followed with respect to the time as of which items of gross income and deductions are to be accounted for. (See articles 50–52.) If the taxpayer does not regularly employ a method of accounting which clearly reflects his income, the computation shall be made in such

manner as in the opinion of the Commissioner clearly reflects it.

ART. 23. *Bases of computation.*—Approved standard methods of accounting will ordinarily be regarded as clearly reflecting income. A method of accounting will not, however, be regarded as clearly reflecting income unless all items of gross income and all deductions are treated with reasonable consistency. See section 200 for definitions of “paid or accrued” and “paid or incurred.” All items of gross income shall be included in the gross income for the taxable year in which they are received by the taxpayer, and deductions taken accordingly, unless in order clearly to reflect income such amounts are to be properly accounted for as of a different period. (See sections 200 (d) and 213 (a).) For instance, in any case in which it is necessary to use an inventory, no accounting in regard to purchases and sales will correctly reflect income except an accrual method. A taxpayer is deemed to have received items of gross income which have been credited to or set apart for him without restriction. (See articles 51 and 52.) * * *

ART. 31. *What included in gross income.*—Gross income includes in general compensation for personal and professional services, business income, profits from sales of and dealings in property, interest, rent, dividends, and gains, profits, and income derived from any source whatever, unless exempt from tax by law. (See section 213 (b).) In general, income is the gain derived from capital, from labor, or from both combined, provided it be understood to include profit gained through a sale or conversion of capital assets. * * *

ART. 50. *When included in gross income.*—Gains, profits, and income are to be

included in the gross income for the taxable year in which they are received by the taxpayer, unless they are included as of a different period in accordance with the approved method of accounting followed by him. (See articles 21-24.) * * *

ART. 541. *Gross income*.—The gross income of a corporation for the purpose of the tax, in general, includes and excludes the same things as the gross income of an individual. It embraces not only the operating revenues, but also gains, profits, and income from all other sources, such as rentals, royalties, interest, dividends from stock in other corporations, and profits from the sale of capital assets. * * *

Treasury Regulations 74, promulgated under the Revenue Act of 1928:

ART. 654. *Net losses for 1926 and 1927 and for the fiscal year 1928*.—If a taxpayer sustained a net loss for the taxable year 1926 or 1927 within the provisions of the Revenue Act of 1926, the amount of the net loss shall be allowed as a deduction in computing net income for the two succeeding taxable years to the same extent and in the same manner as a net loss sustained for one taxable year is, under section 117, allowed as a deduction for the two succeeding years.

* * * * *